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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Magalie Roman Salas, Secretary
Federal Communications Commission
1919 M Street, N.W.
Washington, D.C. 20554

Subject: Comments of State Communications, Inc.; Bell Atlantic/GTE Merger; CC Docket No. 98-184

Dear Ms. Salas:

Printed copies of the comments of State Communications, Inc. were timely filed in the above referenced proceeding on November 23, 1998. Due to a collating error, the exhibit to the comments was placed out of order and appears before the main body of the comments in the final submission. Same day attempts to remedy this problem by filing through the Electronic Comment Filing System were unavailing, as the system reported that this proceeding is not available for filing in ECFS. For the convenience of the Commission and its staff, we are therefore resubmitting printed copies of the comments in the correct order.

Respectfully submitted,

Harry M. Malone
Attorney for State Communications, Inc.

Enclosure

No. of Copies rec'd 0+12
List A B C D E

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

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OFFICE OF THE SECRETARY

In the Applications of	)	
	)	
GTE Corporation, Transferor	)	
and	)	CC Docket No. 98-184
Bell Atlantic Corporation, Transferee	)	
	)	
For Consent to Transfer Control of GTE Corporation and Its Subsidiaries	)	

COMMENTS OF STATE COMMUNICATIONS, INC.

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November 23, 1998

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SUMMARY

In determining whether the proposed merger is in the public interest, it is most important that the Commission be convinced that the merger will enhance competition. As the number of large ILECs decreases through consolidation, the threat to competition becomes greater, creating a greater burden on the Applicants to prove that further mergers are in the public interest. In their joint application, GTE and Bell Atlantic have failed to carry this burden. The proposed merger will do nothing to enhance competition, and will in fact exacerbate the current anticompetitive practices of both companies. Moreover, because of the oligopolistic nature of the resulting market, the Commission will be suffer an impairment in its ability to control the excesses of the large ILECs.

The record shows that both parties to the merger have a history of anti-competitive practices that are intended to thwart the market-opening purposes of the Telecommunications Act. Current regulatory incentives have failed to induce their full cooperation, and there is every reason to believe that the sheer size of the merged entity will only increase the inertia that they have heretofore displayed. The result will mean only continued litigation expense for new entrants and further delay to consumers in receiving the benefits of true competition.

Moreover, this merger will do nothing to promote competition in other ways, and thus there will be no countervailing benefits to balance its harmful effects. Both companies are titans whose financial resources make each of them a formidable competitor standing alone. Not only will a merger between them remove a potential competitor from the field, it will give the merged entity more to lose and cause it a to be even more timid and recalcitrant than the two Applicants currently are. Even if the Applicants do venture out of their domain, it will only be to market long distance services or provide local service to large business customers, joining countless others in a market

that is competitive already, and ignoring the residential and small business customers that could most benefit from real competition.

Approval of this merger would be a repudiation of the principles underlying the Telecommunications Act of 1996. If, however, the Commission somehow finds that the Applicants have met their burden in establishing that the merger is in the public interest, the Commission should attach clear conditions to its approval and establish strong sanctions for violating those conditions. These measures should be crafted in such a way that there is no ambiguity for the Applicants to exploit, as they do now. Perhaps then the Commission will be able to wring some benefit from this ill-advised combination.

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Applications of	)	
	)	
GTE Corporation, Transferor	)	
and	)	CC Docket No. 98-184
Bell Atlantic Corporation, Transferee	)	
	)	
For Consent to Transfer Control of GTE	)	
Corporation and Its Subsidiaries	)	

COMMENTS OF STATE COMMUNICATIONS, INC.

State Communications, Inc. ("SCI"), by its attorneys, respectfully submits these comments in the above captioned proceeding. SCI, a privately held corporation headquartered in Greenville, South Carolina, is a nationwide reseller of local exchange and long distance services. It operates, or has applied for certification to operate, in areas in which Bell Atlantic Corporation ("Bell Atlantic") and GTE Corporation ("GTE") (collectively "Applicants") also operate as incumbent local exchange carriers ("ILECs"). As a consequence of its dealings with these and other large ILECs, SCI is qualified to comment regarding its concerns about the detrimental effect the proposed merger will have on the market for telecommunications services.

I. INTRODUCTION

Before the Commission can approve the transfers of licenses and other authorizations underlying the merger, it must be persuaded that the transaction is in the public interest, convenience and necessity. In particular, it must be convinced that it will enhance competition. "A merger will be pro-competitive if the harms to competition -- *i.e.*, enhancing market power, slowing the decline of market power, or impairing this Commission's ability properly to establish and enforce those rules necessary to establish and maintain the competition that will be a prerequisite to deregulation -- are outweighed by benefits that enhance competition. If Applicants cannot carry this burden, the applications must be denied."[1]

The Commission has previously warned that as competitive concerns increase, it becomes significantly more difficult for applicants to carry their burden to show that the proposed transaction is in the public interest.[2] It foreshadowed this proceeding when it advised that "for some potential mergers, the harm to competition may be so significant that it cannot be offset sufficiently by pro-competitive commitments or efficiencies. In such cases, we would not anticipate the Applicants could carry their burden to show the transaction, even with commitments, is pro-competitive and therefore in the public interest."[3]

This is clearly such a merger. Bell Atlantic already controls over 41 million access lines[4] and serves the headquarters of 175 of the Fortune 500 companies.[5] After merging with GTE, the

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[1] Applications of NYNEX Corporation and Bell Atlantic Corporation for Consent to Transfer Control of NYNEX Corporation and Its Subsidiaries, File No. NSD-L-96-10, *Memorandum Opinion and Order*, 12 FCC Rcd 19985 para. 2 (rel. Aug. 14, 1997) ("*Bell Atlantic/NYNEX Merger Order*").

[2] *Id.* para. 15.

[3] *Id.*

[4] Bell Atlantic Media Fact Sheet, <http://www.ba.com/kit/>(visited Oct. 30, 1998)

[5] "Bell Atlantic and GTE Agree to Merge," Press Release July 28, 1998, <http://www.ba.com/nr/1998/Jul/19980728001.html>(visited Oct. 30, 1998).

combined company will have 63 million access lines,[6] or over one-third of the access lines in the country. The combination of these two giant corporations will hardly promote competition, but instead will only reinforce the anti-competitive predilections of each company and impair the ability of any regulatory body to control them.

The Telecommunications Act was designed to introduce competition into local exchange markets, not resurrect the old Bell monopoly. It is thus the Commission's policy to take action to offset ILECs' market power; to do otherwise "would ensure that only minimal competition develops in local exchange and exchange access telecommunications."[7] If, however, the Commission approves this merger and the SBC/Ameritech merger, it will be breaking faith with the principles of the Telecommunications Act by replacing the Act's vision of free and open competition with a megacarrier oligopoly. At the same time, it will severely threaten the prospects of the true competitors who have invested in local competition.

II. THE MERGER WILL ONLY AID AND ABET THE CONTINUED ANTI-COMPETITIVE BEHAVIOR BY THE PARTIES.

In reviewing this merger and the SBC/Ameritech merger, the Commission's principal focus should be the failure of the incumbent ILECs to implement meaningfully the measures required by the Telecommunications Act of 1996 to open local exchange markets to competition. While other telecommunications markets are becoming competitive, the local market has remained stubbornly

[6] *Id.*

[7] *Bell Atlantic/NYNEX Merger Order* para. 5.

resistant to competitive reform – and this is the market that is of most concern to Congress, the Commission, and the average consumer.

As the Commission is aware, an unknown entrant's attempts to establish itself as a credible provider in a new market rely heavily on the cooperation of the ILEC that is providing wholesale services for resale, interconnection, unbundled network elements or transport and termination and can be frustrated by the incumbent local exchange carrier if that carrier engages in discriminatory conduct affecting service quality, reliability or timeliness.[8] Moreover, the Commission has noted that a "likely harmful effect of mergers of major incumbent LECs is to increase their ability and incentive to resist the pro-competitive process,"[9] and for this and other reasons, it "cannot assume that merely writing the rules called for by the 1996 Act eliminates concerns about potentially harmful effects of some mergers on the development of local telecommunications competition."[10]

A reduction in the number of significant incumbent LECs from six to four – with two companies controlling over two-thirds of all access lines nationwide – will increase the incentive of the merged companies to further resist market-opening measures and to maintain the present geographical division of local markets. The likelihood that these increased incentives will prevail is enhanced by the parties' past record of using their monopoly position in their current regions to resist the market-opening measures required by the 1996 Act. The record demonstrates that Bell Atlantic and GTE have a management philosophy dedicated to the continuing viability of the monopoly model of local telephone service. This management philosophy makes it particularly

[8] *Id.* para. 6.

[9] *Id.* para. 154.

[10] *Id.* para. 6.

likely that the merged company will succumb to the anticompetitive incentives created by this merger, rather than responding in a competitive manner to the forces of change currently at work in the telecommunications market.

The danger of reducing incentives to cooperate with market-opening measures is particularly acute in this merger. At present, Bell Atlantic is seeking Section 271 approval for entry into the long-distance markets in New York, New Jersey, and Pennsylvania and presumably will do so in other states if these applications are approved. Thus Bell Atlantic ostensibly has some incentive to agree to market-opening measures – notwithstanding the small number of lines it has provided to competitors[11] and the various findings of its anticompetitive practices.[12] However, even this poor showing seems salutary when contrasted with GTE, which is already in the long-distance market, and, as a consequence, has taken an extremely recalcitrant attitude toward competition.[13] GTE's "scorched-earth' tactics have been totally successful in keeping significant competition out of its

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[11] The number of total local lines Bell Atlantic provided other carriers (Total Service Resale and UNE), as a percentage of its total lines in service, is: Washington, D.C. - 0.75%; Delaware - 1.4%; Massachusetts - 2%; Maryland - 0.4%; Maine - 0.3%; New Hampshire - 1.1%; New Jersey - 0.4%; New York - 2%; Pennsylvania - 1.4%; Rhode Island - 0.8%; Virginia - 0.3%; Vermont - 0.2%; West Virginia - 0%. <http://www.fcc.gov/ccb/local-competition/survey /responses>(visited Nov. 16, 1998) Of the total lines Bell Atlantic provided other carriers, 12.3% were UNEs. *Id.*

[12] *See* CTC Communications Corp, Mass. DTE Docket No. 98-18, *Order* (rel. July 2, 1998)(petition for reconsideration filed); Complaint and Request of CTC Communications Corp, NY PSC Case No. 98-0426, *Order* (rel. Sep. 14, 1998); CTC Communications Corporation Petition for Enforcement of Resale Agreement, NH PUC Case No. 98-061, *Order No. 23, 040*, (rel. Oct. 7, 1998).

[13] The difference between GTE and the RBOCs became apparent soon after the 1996 Act was passed. Ameritech's CEO was quoted as saying: "The big difference between us and them [GTE] is they're already in long distance. What's their incentive to cooperate?" "Holding the Line on Phone Rivalry, GTE Keeps Potential Competitors, Regulators' Price Guidelines at Bay," *Washington Post*, October 23, 1996, at C12.

service areas.[14] After the merger, the merged company will have to consider whether the possible benefits of market-opening measures, which might have been persuasive to Bell Atlantic, might be offset by the "adverse" precedent set in terms of opening up the market in GTE service areas. With control of over one-third of the nation's access lines at stake, the merged company may well conclude that the benefits of cooperation in terms of Section 271 approval are not worth the cost in terms of losing its control over access lines.

State Communications has had first-hand experience in dealing with GTE's steadfast resistance to the market-opening measures required by the Telecommunications Act of 1996. In the resale agreement between the parties, GTE has insisted on:

- Unilaterally terminating the interconnection agreement when GTE sells an exchange to another carrier, leaving State Communications with no means of serving its customers;[15]

- Refusing to retroactively credit State Communications for payments higher than those subsequently arbitrated before the state commission, an unreasonable practice in violation of section 201 of the Act;[16]

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[14] The success of GTE's tactics is well documented. In its response to the Second CCB Survey on the State of Local Competition, GTE reported the total of local lines it has provided to other carriers and the total lines it has in service, as of June 30, 1998. The number of total local lines GTE provided other carriers (Total Service Resale and UNE), as a percentage of its total lines in service, is: California - 0.9%; Florida - 1.7%; Hawaii - .02%; Illinois - .005%; Indiana - .0007%; Kentucky - 0.2%; Michigan - 0%; North Carolina - 0.2%; Ohio - .004%; Oregon - .03%; Pennsylvania - .01%; Texas - 1.1%; Virginia - .02%; Washington - .02%; Wisconsin - .06%. <http://www.fcc.gov/ccb/local-competition/survey/responses> (visited Nov. 16, 1998) Of the total lines GTE provided other carriers, slightly under1% were UNEs. *Id.*

[15] Resale Agreement Between GTE South Inc. and State Communications, Inc., § III.2.5. [Attached hereto as Exhibit 1]

[16] *Id.* § III.45

- Requiring, by contrast, retroactive payment of its original rates if lower arbitrated rates are later stayed, enjoined, or modified (a portent of GTE's intent to appeal all arbitration orders);[17]

- Refusing to honor newly arbitrated rates at the time they are set, and instead delaying their effectiveness until thirty days after State Communications elects those rates, a procedure which in turn must be delayed until the arbitrated agreement is signed, filed, and approved by the state commission – a process that can take years;[18]

- Refusing to deduct avoided costs from non-recurring charges for resold services, in violation of the Act.[19]

These and many other demands are clearly designed to make local competition prohibitively expensive in terms of time and money. Consequently, it is frightening to hear that the Applicants have promised to "spread[] each company's best practices to the entire merged company."[20] Considering how aggressively GTE has employed its practice of delaying and hindering local competition, it must be presumed that this must be one of the best, if not *the* best, of its practices. Therefore, the Commission should expect the merged entity to use its greater scale and combined expertise to a devastating effect against local competition.

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[17] *Id.*

[18] *Id.*

[19] *Id.* App. A

[20] Application of GTE Corporation and Bell Atlantic Corporation for Transfer of Control, Public Interest Statement in Support of Application at 22 (Oct. 2, 1998)("Public Interest Statement").

III. THE MERGER WILL DO NOTHING TO PROMOTE COMPETITION

A. There Is No Financial Justification for this Merger

The Application strongly implies that the Applicants cannot effectively compete unless they exploit the "greater scale" that the merged entity would possess.[21] This is a specious argument. GTE is already a huge company – in 1997, it had revenues of over $23 billion, operating income of $5.6 billion, and net income approaching $2.8 billion.[22] By itself, GTE is already in the same league as two of the three companies that the Applicants have named as principal competitors – Sprint and MCI WorldCom.[23] GTE continues to do well – its operating income for the third quarter 1998 increased by 11%, and its net income by 8.7% over the third quarter 1997.[24] In its latest annual report, it boasts that it is not only "one of the world's largest telecommunications companies," but also that it is "a leading provider of integrated telecommunications services" – providing "local service in 28 states and wireless service in 17 states, nationwide long-distance service and Internet working services ranging from dial-up Internet access for residential and small-business consumers

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[21] *Id.* 7-8.

[22] GTE Annual Report 1997, Consolidated Financial Highlights.

[23] Sprint reported 1997 annual revenues of $14 billion. Sprint 1997 Annual Report. MCI and WorldCom had combined 1997 revenues of $27 billion. WorldCom SEC Form 10-K (1997); MCI SEC Form 10-K (1997).

[24] "GTE Reports 11% Consolidated Operating Income Growth and Double-Digit Core EPS Growth in Third Quarter," Press Release, Oct. 19, 1998, <http://www.gte.com/AboutGTE/news/3Q98.html>(visited Nov. 17, 1998).

to Web-based applications for Fortune 500 companies, and video service in selected markets."[25] In short, GTE already has all the financial clout it needs to compete in any market, together with the broad range of products it needs to offer its customers a total package of services.

The Application itself admits that GTE is already well-positioned to provide facilities-based competition in many cities.[26] In fact, before the proposed merger was contemplated, GTE had acknowledged that it has "an imperative to compete given its island-like service areas in the other Bells' seas," and consequently "already has established a separate corporate unit to plan for entry into territory close to its own few urban franchise areas near Los Angeles, Dallas, Tampa, and Seattle."[27] Nevertheless, they now contend that GTE cannot compete until it can obtain the advantage of "anchor customers" through a Bell Atlantic connection.[28] This ignores the fact that even though many of the CLECs competing for large corporate customers do not have the advantage of existing "anchor customers," CLEC competition for large corporate customers is beginning to become significant.[29] Moreover, the "anchor customers" that MCI WorldCom and Sprint have were originally acquired the old fashioned way – by competing for them in the open market.

GTE and Bell Atlantic could seek "anchor customers" the same way, except that they do not want to dirty their hands competing for them. GTE has ample resources to support an aggressive

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[25] GTE Corporation Annual Report 1997, "Introduction - About GTE," available at <http://www.gte.com/g/annual1997/bigidea.html>(visited Nov. 17, 1998).

[26] Public Interest Statement at 1-2, 6-7.

[27] Public Interest Statement at 7.

[28] Application of GTE Corporation and Bell Atlantic Corporation for Transfer of Control, Declaration of Jeffrey C. Kissell in Support of Application para. 7 (Oct. 2, 1998)("Kissell Decl.")

[29] *MCI/WorldCom Merger Order*, paras. 172-182.

marketing campaign, if it dares. It is already in several suburban markets adjacent to prime urban markets now controlled by RBOCs. It is already in a position to offer corporate customers long-distance and advanced data-transmission services. It should not need existing "anchor customer" relationships to mount a credible marketing campaign for out-of-region corporate customers, and to use that campaign as a platform for reaching smaller businesses and residential customers. The fact that it chooses not to compete affirms the Commission's observation that the merger route is cheaper and less risky than competitive marketing;[30] the Commission should therefore expect that this method will continue to be pursued unless and until the Commission makes it clear that the merger wave in this industry has gone far enough.

There is simply no reason (other than obtaining a monopolistic advantage) why GTE needs to merge with Bell Atlantic to compete outside its current service areas. That fact was acknowledged by GTE's Chairman and CEO in the company's Annual Report of 1997, where he stated:

> We're confident about GTE's ability to succeed in the competitive marketplace *without* entering into a major transaction or combination with another company. In other words, we can go it alone and win.[31]

Simply put, the "anchor customer" argument is a monopolist's proposal to use the captive customer base within its present region to leverage its way into out-of-region markets. Under this proposal, the merged company would be "employing [its] monopoly power as a trade weapon against [its] competitors." *United States v. Griffith*, 334 U.S. 100, 107 (1948). This is in no way a

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[30] "When facing a changing regulatory environment that reduces barrier to entry, firms that would otherwise compete directly may, as one possible strategic response, seek to cooperate through merger." *Bell Atlantic/NYNEX Merger Order* para. 3.

[31] GTE Corporation Annual Report 1997, Chairman's Message (emphasis in original).

benefit of the proposed merger; instead, it is an anticompetitive effect. If anything, the financial result of the proposed merger will be to increase the already massive rate-base from which the Applicants can fund their war-chest in the fight to defeat the goals of the Telecommunications Act.[32] The Commission should draw the line on this behavior now.

B. The Proposed Merger Will Reduce Competition

"Is this merger going to create competition, or will it be a non-aggression pact?"[33]

This merger will remove both Applicants as agents of change in assailing the dominance of the other, and it will further reduce the incentive for out-of-region competition. The Commission recognizes that "[i]n telecommunications markets that are virtual monopolies or that are not yet developed . . . the loss of even one significant market participant can adversely affect the development of competition and the attendant proposals for deregulation."[34] Even now, the present ILECs, with few exceptions, have maintained a geographical division of markets by refraining from significant competitive forays into each other's territories – despite the fact that each ILEC has far more assets and far greater managerial and technical expertise in the provision of local exchange

[32] For example, GTE has consistently attempted (unsuccessfully) to short circuit the state arbitration process by appealing interconnection agreements directly to federal courts before the agreements have been passed on by state commissions. *See e.g., GTE North v. Strand*, No. 5:97CV01, 1997 WL 811422 (W.D.Mich.) *GTE Southwest, Inc. v. Graves*, 989 F.Supp. 1148, 1150 (W.D.Okla.1997); *GTE North Inc. v. Glazer*, 989 F.Supp. 922 (N.D.Ohio 1997); *GTE Northwest, Inc. v. Nelson*, 969 F.Supp. 654 (D.Wash.1997); *GTE Florida, Inc. v. Johnson*, 964 F.Supp. 333 (N.D.Fla.1997); *GTE South Inc. v. Breathitt*, 963 F.Supp. 610 (E.D.Ky.1997); *GTE South Inc. v. Morrison*, 957 F.Supp. 800 (E.D.Va.1997). Also, *see infra* page18 for a discussion of legal proceedings related to GTE's attempts to preserve prohibited cost recovery and universal service support payments.

[33] Statement of Chairman William E. Kennard on the Potential Merger of SBC and Ameritech, FCC News, May 11, 1998.

[34] *Bell Atlantic/NYNEX Merger Order* para. 66.

service than most CLECs. "As the number of most significant market participants decreases, all other things being equal, the remaining firms are increasingly able to arrive at mutually beneficial market equilibria, to the detriment of consumers."[35]

This merger, in conjunction with the SBC/Ameritech merger, further reduces the likelihood that the merged companies will find it in their interest to disturb the "mutually beneficial equilibrium" represented by the existing geographical division of markets. In the SBC/Ameritech merger application, for example, the parties candidly acknowledge that they expect any out-of-region competitive foray by the merged company to elicit retaliation by the incumbent LEC.[36] Given that prospect, an ILEC planning an out-of-region competitive foray has to consider whether the benefits of the possible additional business to be garnered outweigh not only the direct cost of the foray, but also the cost of defending against a retaliatory raid and the loss of business that might result. Indeed, a merged GTE and Bell Atlantic would have much to defend; targets for retaliation would include New York City and the entire Boston-Washington corridor – markets teeming with lucrative business customers, providing plump targets should the merged company ignite competitive warfare.

In these circumstances, the likely result is that both parties will find it mutually beneficial to refrain from venturing into each other's territory – thereby continuing to collect the profits from their own monopolies, while avoiding the risk and expense of competitive warfare in each other's territory. Thus this merger, in combination with the SBC/Ameritech merger, reduces the chance that the preliminary signs we are now seeing of a break in the present geographical division of markets

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[35] *Id.* para. 121.

[36] Application of SBC Communications, Inc. and Ameritech Corporation for Transfer of Control, Public Interest Statement in Support of Application at 7-8 (Jul. 24, 1998).

among the ILECs will actually result in serious inter-ILEC competition. One noted analyst, past Commission General Counsel Henry Geller, doubts that any of the major local companies would ever mount a serious challenge to one another. "I think they took one look at that and said, Wall Street will really punish us if we do anything that stupid."[37]

Even if the merged company does engage in out-or-region competition, that competition will be focused on large business customers -- the one segment of the local exchange market that the Commission has found is already on the road to becoming competitive.[38] Moreover GTE admits that the initial focus of the merged company's out-of-region competition will be to "build on Bell Atlantic's existing account relationships with large businesses."[39] The merged company is unlikely to be motivated to expand out-of-region beyond the large corporate customers with which Bell Atlantic has an existing relationship. As previously discussed, any out-of-region competitive campaign by the merged company's CLEC would carry the danger of retaliation by the incumbent LEC – a danger other CLECs do not incur, because they have no home region against which retaliation could be targeted. It is likely that, because of the danger of retaliation, the merged company will continue to participate in the present tacit agreement to divide territories, and refrain from any serious out-of-region competition.

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[37] Jon Healey, *Home Telephone Market Difficult for Competitors*, San Jose Mercury News (posted Aug. 2, 1998) <http://www.sjmercury.com/business/center/compete080398.htm> (visited Nov. 16, 1998).

[38] In the *MCI/WorldCom Merger Order*, the Commission found that, while the incumbent LECs still dominate the larger business market, "they face increasing competition from numerous new facilities-based carriers in serving the larger business market." *MCI/WorldCom Merger Order* para. 172.

[39] Kissell Decl. para 7.

Thus, rather than bringing competition to the residential and small business segments where significant competition is most needed, the Applicants seek to gingerly enter an increasingly crowded segment, all the while obstructing other CLECs from entering the Applicants' own residential and small business segment. The benefit to the public interest of such a strategy is negligible. The solution to the problems of local competition is to enforce the market-opening requirements of the Telecommunications Act of 1996 — not to approve an anticompetitive merger on the basis of a dubious promise that the merged company will successfully become a significant local competitor in markets where other large and well-financed CLECs have struggled to overcome the incumbent's resistance to market-opening measures.

C. The Merger Will Effect No Discernable Benefit to Competition in the Long Distance Market.

The Applicants claim that the merger will enhance competition in the long-distance market, by enabling the merged company to construct and operate a national long distance network. They assert that there are presently only three "fully national facilities-based carriers" (MCI WorldCom, AT&T and Sprint), and that a fourth national network will add significantly to competition.[40]

The Commission already knows this is not the case, having previously concluded that "the supply of transmission capacity is expanding significantly with the construction of four new national fiber-optic networks by Qwest, IXC, Williams, and Level 3."[41] In light of this new capacity, the Commission found that there would be a sufficient number of national facilities-based carriers to "constrain any attempted exercise of market power," and that "new carriers likely will be able to

[40] Public Interest Statement at 4, 18-20.

[41] *MCI/WorldCom Merger Order* para. 43.

constrain any coordinated exercise of market power by the incumbents."[42] The Commission concluded that "the coverage of the new networks is sufficient to provide competitive national long distance service."[43]

In short, there will shortly be four additional national networks – not merely the three to which Applicants refer. That makes a total of seven national networks. The addition of an eighth national network, in a market the Commission has already found to be competitive, can hardly be claimed as a significant public benefit.

Moreover, the claim that either GTE or Bell Atlantic could not build an eighth network without the merger – assuming the market demand for such a network exists – is not credible. Bell Atlantic and GTE are vastly larger companies than Qwest, IXC, Williams or Level 3 – the companies described by the FCC as building the four new national fiber-optic networks that will guarantee the continued competitiveness of the long-distance market.[44] Nor did these companies have the ready-made supply of Fortune 500 "anchor customers" that Bell Atlantic has and that GTE is seeking through this merger. The achievement of Qwest, IXC, Williams and Level 3 demonstrates that significant, competition-enhancing network investments can be made without the ready-made customer base that GTE says it needs to acquire.

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[42] *Id.* paras. 51, 64.

[43] *Id.* para. 54.

[44] GTE's revenue for 3Q 1998 was $6.4 billion, and Bell Atlantic's was $7.9 billion. Qwest's was $880 million; IXC's $185 million, and Level 3's $106 million. *See* <http://www.gte.com/g/3Q98/table1.html>(visited October 21, 1998);<http://www.bell-atl.com/invest/financial/quarterly/3q98.html>(visited November 9,1998); <http://www.qwest.net>(visited November 2, 1998);<www.level3.com>(visited November 2, 1998);< http://www.ixc-investor.com/press.html>(visited November 9, 1998).

Clearly, the Applicants have not shown that, individually, they would be ineffective competitors to AT&T, Sprint, MCI and other interexchange carriers. To the contrary, the Commission should find, as it has in the past, that GTE's experience in offering in-region, interexchange services suggests that Applicants will be quite effective competitors once they receive authorization pursuant to Section 271 of the Communications Act to offer in-region interexchange services.[45]

D. The Proposed Merger Will Impair the Commission's Ability to Regulate in Favor in Increased Competition.

A reduction in the number of separately owned firms engaged in similar businesses will tend to reduce the Commission's ability to identify, and therefore to contain, market power. It has found that one way this can happen is by reducing the number of separately owned and operated carriers that can act as "benchmarks" for evaluating the conduct of other carriers or the industry as a whole.[46] "We find that the ability to compare actions of a larger number of carriers improves our ability to identify and constrain market power."[47]

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[45] *Bell Atlantic/NYNEX Merger Order* para. 172, citing Zaiba Nanji and Kirk Parsons, *So Many Choices*, Telephony, July 14, 1997 (reporting that J.D. Power research indicates that approximately one-third of SNET's local customer base currently uses the company to place long-distance calls, and that GTE signed up a million long-distance customers within its first year of offering the service).

[46] That benchmarks can be of value for regulation is explained by the economic theory of principal-agent relationships. *See, e.g.*, Bengt Holmstrom, *Moral Hazard and Observability*, 10 Bell J. Econ. 74-91 (1979). Holmstrom observes that agent performance improves when the principal can obtain additional sources of information about the agent's activity or the state of nature.

[47] *Bell Atlantic/NYNEX Merger Order* para. 147.

Regarding last year's Bell Atlantic/NYNEX merger, the Commission was nonplused at the prospect of only 5 Bell Operating Companies, but cautioned that further reductions would become "more and more problematic as the potential for coordinated behavior increases and the impact of individual company actions on our aggregate measures of the industry's performance grows" and that "further reductions in the number of Bell Companies or comparable incumbent LECs would present serious public interest concerns."[48]

IV. THE ANTICOMPETITIVE EFFECTS OF THE MERGER CANNOT BE MITIGATED BY APPROVAL SUBJECT TO CONDITIONS

In the Bell Atlantic/NYNEX merger, the Commission took the approach of approving the merger subject to certain market-opening conditions. However, that approach has not been a success, as evidenced by MCI's recent complaint filed with the Commission charging Bell Atlantic with numerous violations of those conditions.[49] The essential problem with approval conditions is that the merger cannot be undone once it is approved, and the prospect of other penalties is unlikely to deter the merged company from resisting implementation of market-opening measures – particularly when monopoly control over one-third of the access lines in the country is at stake.

The likelihood that conditions to merger approval will be ineffective is particularly high where the merger, as here, is between parties with a history of resistance to the market-opening requirement of the Telecommunications Act of 1996. Given the parties' management philosophy

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[48] *Id.* para. 156.

[49] Complaint of MCI Telecommunications Corporation and MCImetro Access Transmission Services, Inc., File No. E-98-32 (filed Mar. 17, 1998).

which this history demonstrates, it is fair to expect that the merged company will also resist implementation of any market-opening conditions the Commission may attach to approval of the merger.

V. IF THE MERGER IS APPROVED, IT SHOULD BE SUBJECT TO STRINGENT MARKET-OPENING CONDITIONS

If this merger is approved, improved conditions are needed to ensure that the merged company will truly open its markets to competitive entry, and swift sanctions are essential to address any failure to comply with these market-opening conditions.

A. Conditions

If the merger is to be approved, further measures are needed to ensure that competition takes root in the new super-ILEC's service territories. Most of these measures are designed to impede the litigation juggernaut that the ILECs have employed to drain the CLECs of start-up capital. Specifically, the Commission should address the following concerns in structuring conditions for merger approval:

1. ***Pricing:*** Since enactment of the Telecommunications Act of 1996, GTE has consistently taken the position that it should be entitled to recover all of its historical costs from competitors through UNE prices, notwithstanding the forward-looking cost standard contained in section 252(d) of the Act. From Missouri to Hawaii to Indiana to Minnesota to North Carolina,[50]

[50] Case No. TO-97-124 (Mo. P.S.C.); Docket 7702 (Hawaii P.U.C.); Cause No. 40618 (Indiana U.R.C.); Docket No. P-442, 407/M-96-939 (Minn. P.U.C.); Docket No. P-100, Sub133d (North Carolina U.C.).

GTE has repeatedly argued in defiance of the 1996 Act, which expressly prohibits the kind of stranded cost recovery that GTE has proposed in state after state.[51]

The need for such a forward-looking pricing condition is all the more apparent when one considers that GTE also has tried to protect its historical revenue streams by proposing in several states that competitors pay a so-called "universal service" surcharge directly to GTE.[52] Again, this surcharge has no relationship whatsoever to the pricing standards in the Act; GTE would have its competitors pay this extra amount to ensure that it does not lose any "support" when those competitors take certain customers off of GTE's network. Nor does this proposed surcharge have any relation to universal service principles under the Act, as a mechanism that pays directly to the incumbent carrier for alleged losses of implicit subsidies can hardly be considered competitively neutral.[53] In fact, even though the fundamental principle of universal service is to make telecommunications affordable for consumers,[54] GTE's proposed surcharges have been aimed solely at making the provision of telecommunications profitable for GTE. To defeat this type of scheming, the Commission should require as a condition of merger approval that GTE charge forward-looking prices – and only forward-looking prices – to new entrants seeking to compete with GTE. In

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[51] Section 252(d) of the Act specifically limits the costs that ILECs will be allowed to recover to those costs "determined without reference to a rate-of-return or other rate-based proceeding." 47 U.S.C. § 252(d)(1)(A)(i) (West Supp.1996).

[52] Docket 7702 (Hawaii P.U.C.)(proposed Decision and Order rejecting universal service surcharge by GTE as inconsistent with principles of competitive neutrality); Cause No. 40618 (Indiana U.R.C.); Docket No. P-100, Sub133d (North Carolina U.C.). A decision on the proposed interim surcharge is pending in the North Carolina proceeding, while consideration of this issue has been transferred to a general universal service docket by the Indiana commission.

[53] 47 U.S.C. § 254(b)(4) (West Supp. 1996).

[54] *Id.* § 251(b)(1).

connection with this effort to ensure that effective competition takes roots in GTE territory before the merger, the Commission should also require GTE to provide discounts on resold services and prices for unbundled network elements that truly comply with the methodology set forth in this Commission's Local Service Guidelines and with the FCC's *Local Competition Order*.[55] GTE should not be permitted to relitigate its stranded cost and interim universal service surcharge theories so that CLECs are forced to spend time and resources overcoming these barriers to entry. Only by making the establishment of forward-looking UNE prices a condition of merger approval can this Commission adequately ensure that make-whole schemes such as the so-called "stranded cost recovery" and "interim universal service surcharge" that GTE has proposed in other states will not serve to deter competitive entry into GTE's markets. In short, the Commission should require as a condition of merger approval that GTE charge forward-looking prices – and *only* forward-looking prices – to new entrants seeking to compete with GTE.

2. ***Availability of Arbitrated Rates:*** In a number of states, GTE is declining to make available to other carriers those UNE prices and resold discounts that are the product of its arbitrations with AT&T. Because AT&T and GTE have not executed final interconnection agreements in many states, GTE prevents other CLECs from purchasing UNEs and resold services from GTE at the arbitrated rates. In essence, GTE would require each CLEC to relitigate the same cost studies to obtain these rates.[56] Quite simply, this is a barrier to entry that GTE has erected out

[55] *See* Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, CC Docket No. 96-98, *First Report and Order,* 11 FCC Rcd 15499, paras. 690-98, 907-34 (rel. Aug. 8, 1996).

[56] *See, e.g.*, US Xchange of Indiana, L.L.C. Petition for Arbitration Pursuant to 47 U.S.C. § 252(b) of Interconnection Rates, Terms, and Conditions With GTE North Incorporated and Contel

of legal fiction. Requiring GTE to make its arbitrated rates available to all competitors will dramatically reduce the legal costs associated with competitive entry and spare state commissions the administrative burden of repetitive arbitration proceedings.

3. ***Special Construction Charges:*** The Commission should require the new Bell Atlantic-GTE to refrain from charging special construction charges to CLECs – or to the CLECs' end users – when such charges would not be charged to the merged entity's own end user customers. Moreover, to the extent that such charges are imposed upon CLECs or their end users, the merged entity should be required to provide justification for imposing these charges and forward-looking TELRIC analyses supporting their imposition if challenged.

4. ***IntraLATA Toll Dialing Parity:*** The Commission should require the new Bell Atlantic-GTE to provide 1+ intraLATA dialing parity in all states throughout its combined region by no later than February 8, 1999, if not otherwise required to implement dialing parity sooner. In state after state, Bell Atlantic has litigated and lost on the position that it is not required to implement toll dialing parity by this date under the Act. Requiring GTE to provide dialing parity will dramatically reduce the legal costs associated with competitive entry and spare state commissions the administrative burden of repetitive arbitration proceedings.

5. ***Combinations of UNEs:*** The Commission should require the new Bell Atlantic-GTE to provide technically feasible combinations of network elements at forward-looking cost-based rates. The refusal to provide network element combinations – or alternatively, the

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of the South, Inc. d/b/a GTE Systems of the South, Cause No. 41034-INT-01 (I.U.R.C. Feb. 11, 1998) (adopting AT&T-GTE arbitrated rates on an interim basis after GTE attempted to compel US Xchange to take higher rates).

placement of limitations on the use of UNE combinations – has no basis in technology or in economics, and is merely a legal hurdle used to inhibit competitive entry.

6. ***Operations Support Systems:*** The Commission should require the new Bell Atlantic-GTE to commit to immediate development of operational support systems ("OSS") that will enable CLECs and other new entrants to provide service to their end users in parity with the service that the new ILEC provides to its end users.

7. ***Non-Recurring Charges:*** Bell Atlantic-GTE should be required to impose only reasonable, cost-based non-recurring charges ("NRCs") for services provided to competitors. In the resale context, where there is a retail analog to the charge that would be imposed upon the reseller, these NRCs should be developed on the basis of an avoided cost analysis that applies a wholesale discount to the retail NRC. GTE has refused to do this. In the context of UNEs and where a retail analogue does not exist for a resale NRC (*e.g.*, a service migration charge), the NRCs should be developed using TELRIC principles.

8. ***Resale of Voicemail:*** If the merger is to be approved, Bell Atlantic-GTE should be required to make its voicemail services ("VMS") available for resale at an avoided cost discount, or at the very least, at the retail price for those services. Technical limitations and economic barriers prevent resellers from offering VMS in the same manner and at the same level of quality that the ILEC offers to its own customers. The inability to provide VMS places resellers at a competitive disadvantage, as they cannot offer an entire segment of the ILEC's customer base the VMS they have come to expect from the incumbent. Requiring Bell Atlantic-GTE to provide VMS for resale would eliminate the tying arrangement between the ILEC's local exchange service and its

VMS, and provide resellers with the opportunity to compete for each and every customer in the ILEC's embedded customer base.

9. ***Performance Reports:*** The Commission should also require the combined Bell Atlantic-GTE to submit *monthly* performance reports, in lieu of the quarterly reports required in the context of the BA-NYNEX merger.[57] Since Bell Atlantic is already compiling data on a monthly basis under the existing merger conditions, it should not be too much of an additional burden to publish those results on a monthly basis as well. By contrast, a span of even three months can make a substantial difference in deciding whether to enter a market or in attempting to withstand the continuing anticompetitive conduct of an incumbent – especially one like the proposed Bell Atlantic-GTE company, which would have a monopolistic level of market share and bottleneck control of essential facilities across such a large span of the nation.

10. ***Performance Standards:*** Finally, the Commission should attach conditions to the merger compelling Bell Atlantic-GTE to satisfy certain levels of performance in providing interconnection services, UNEs, and resold services to competitors. For each reporting category imposed as part of Condition 9, the new merged entity should be required to meet a certain threshold of performance (whether it be a set interval or a specific success rate) so that carriers can determine with certainty when Bell Atlantic-GTE is discriminating in the provision of service.

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[57] *Bell Atlantic/NYNEX Merger Order*, at Appendix C.1.d.

B. Sanctions

It is clear that, for the large ILECs in general and GTE in particular, extended litigation designed to frustrate the procompetitive aims of the Telecommunications Act is merely, and literally, a cost of doing business. It should be obvious by now that litigation, obfuscation, and delay are fundamental to a strategy to exhaust the resources of new entrants by forcing captive ratepayers to fund a war of attrition that deprives those same ratepayers of competitive choices.

More detailed conditions and more stringent reporting requirements are only a means to an end in minimizing the new merged entity's ability to discriminate against competitors. The larger question is whether CLECs will be able to do anything if they discover that the new Bell Atlantic-GTE is in fact engaging in discriminatory conduct or violating the merger conditions. Unfortunately, as the MCI Complaint demonstrates, reliance upon the Commission's complaint procedures may not bring speedy resolution. Unlike most CLECs, however, the Commission can muster the financial leverage to grasp and hold the ILECs' attention. Thus, the Commission should establish a system of reasonable yet strict financial sanctions for failure to adhere to the performance standards incorporated in the merger conditions. For example, if the combined Bell Atlantic-GTE's performance in any category in which it is required to report falls below the level of performance it provides for its own operations for a period of time, the Commission should assess substantial damages. It should be noted that Bell Atlantic has previously entered into interconnection agreements that provide for such liquidated damages in cases of performance breaches.[58]

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[58] *E.g.*, Interconnection Agreement-New York between New York Telephone Company and MFS Intelenet of New York, Inc., Article 27.

Moreover, the Commission should create an entirely separate system of penalties to be imposed if Bell Atlantic-GTE violates any of the other, non-performance related merger conditions. For example, in instances in which the merged entity fails to provide reports on a monthly basis or refuses to resell VMS to competitors, the Commission should impose a penalty of $500 per day for a continuing violation. As in the case of performance breaches, this amount also has a sound basis; 47 U.S.C. § 502 allows the Commission to impose such a fine for each and every day that a person willingly and knowingly violates any Commission rule, regulation, restriction, or condition. Such sanctions will avoid the need for lengthy, time-consuming, and expensive litigation in each case when Bell Atlantic-GTE fails to satisfy a condition of the merger.

CONCLUSION

SCI urges the Commission to find that the Applicants have failed to meet the burden of demonstrating that the proposed merger is in the public interest. The proposed merger will not enhance competition, and will in fact further the anticompetitive strategy of the Applicants. Alternatively, should the Commission approve this merger, it should only be under stringent conditions, enforceable by firm sanctions, as proposed herein.

Respectfully submitted,

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November 23, 1998

260291.1

EXHIBIT 1

RESALE AGREEMENT BETWEEN
GTE SOUTH INC.
AND
STATE COMMUNICATIONS, INC.

RESALE AGREEMENT

BETWEEN

GTE SOUTH INCORPORATED

AND

STATE COMMUNICATIONS, INC.

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This Resale Agreement (the "Agreement"), is made effective as of ______________, 199__, by and between GTE South Incorporated, with its address for purposes of this Agreement at 600 Hidden Ridge Drive, Irving, Texas 75038 ("GTE"), and State Communications, Inc., in its capacity as a certified provider of local dial-tone service ("State Communications"), with its address for this Agreement at 200 N. Main Street, Suite 303, Greenville, SC 29601 (GTE and State Communications being referred to collectively as the "Parties" and individually as a "Party"). This Agreement covers services in the state of South Carolina only (the "State").

WHEREAS, Section 251 of the Telecommunications Act of 1996 (the "Act") imposes specific obligations on LECs with respect to the resale of telecommunications services; and

WHEREAS, GTE is entering into certain aspects of this Agreement which provide State Communications with the option of replacing certain rates set forth in this Agreement with the rates from a particular Commission-approved arbitrated agreement between GTE and an arbitrating CLEC, pursuant to Article III, Section 45 herein. GTE has entered into such terms, which may cause adverse results from an arbitrated agreement to be incorporated into this Agreement at a future date, in order to avoid the expense of arbitration while at the same time preserving its legal positions, rights and remedies; and

NOW, THEREFORE, in consideration of the mutual provisions contained herein and other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, GTE and State Communications hereby covenant and agree as follows: